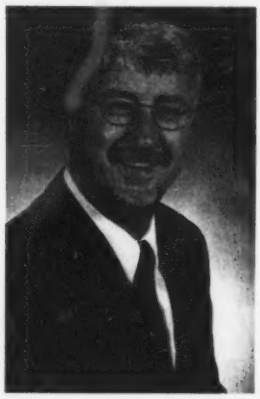
Prince Edward Island
CANADA

PEI LENDING AGENCY

Message from the Minister Designate

The Honourable J. Léonce Bernard
Lieutenant Governor of Prince Edward Island
PO Box 2000
Charlottetown, PE C1A 7N8



May It Please Your Honour:

Pursuant to the *PEI Lending Agency Act* and
as minister designate for the time period
covered by this report,
it is my privilege to submit the Annual Report
of the PEI Lending Agency
for the period ending March 31, 2005.

Respectfully submitted,

Mitch Murphy

Mitch Murphy
Provincial Treasurer

Table of Contents

Message From the Board Chair 1

Message From the Chief Executive Officer 3

Mandate of the PEI Lending Agency 5

Corporate Profile 7

Year in Review 9

Compte rendu de l'année 17

Appendices

Appendix A – Corporate Directory

Appendix B – Organizational Chart

Appendix C – Auditor's Report

Appendix D – Financial Statements

Appendix E – Clarification to Note 4 of Financial Statement

Appendix F – Application Statistics for April 1, 2004, to March 31, 2005

Message From the Board Chair

March 31, 2005

The Honourable Mitch Murphy
Provincial Treasurer
Province of Prince Edward Island

Dear Minister:

On behalf of the board of directors of the PEI Lending Agency, I take pleasure in presenting you with this, the Annual Report of the agency for the fiscal year ending March 31, 2005.

This report is being presented pursuant to the *PEI Lending Agency Act* and Regulations.

Sincerely,

Brian MacPhee

Brian MacPhee
Chairman, Board of Directors
PEI Lending Agency

Message From the Chief Executive Officer

Mr. Brian MacPhee, Chairman
Board of Directors
PEI Lending Agency

Dear Mr. MacPhee:

I respectfully submit the Annual Report of the PEI Lending Agency for the 2004-2005 fiscal year.

For the period ending March 31, 2005, the agency required an increase in the annual grant from the province, primarily to offset a necessary provision for loan losses. This increase in provision, as recommended by the agency's external auditors, was a cautionary measure in response to a number of loans invested in sectors of the Island's economy, as well as, specific businesses experiencing financial difficulties.

When re-established as a crown corporation in 1998, the agency's objective was to achieve a break-even operation, on a five-year averaging basis. To date, this has been managed; however, as a result of various impacting factors including program and industry support as well as the "developmental role" aspect of the Agency's mandate, this target may need to be realistically revisited. Alternatively, acquisition of a larger "low risk" component of the portfolio will be necessary to better balance the portfolio and offset this higher risk element. Solicitation of clients with above-average profitability potential would be ideal, however achieving this objective can be challenging in consideration of various competitive limitations. Either attractive financial packages or products will be required or, more favourably, the ability to offer rates according to risk would offer the most potential for increasing business.

Agency staff remain committed to finding new ways to meet the demands of Island businesses, to minimizing the potential for loss and to providing the best possible service to clients. As Chief Executive Officer, I will continue to strive to meet the financial objectives established by both the board of directors and government and to seek ways to best serve the public's interest.

Respectfully submitted,

P.A. Wilson
Chief Executive Officer

Mandate of the PEI Lending Agency

The mandate of the PEI Lending Agency is to provide financial assistance, through loan agreements, in support of the Government's economic development strategy and to support enterprises that demonstrate reasonable viability, though are unable to access private sector financing or the terms and conditions required to meet their needs.

The agency is to operate as a responsible, professional lender, basing decisions or recommendations on sound lending practices. Under the authority of the *PEI Lending Agency Act* and Regulations, the board of directors, consisting of six private sector and two Government-designated directors, provide agency staff with consistent guidance and direction. They strive to meet the needs of Island industries and individual businesses throughout the constantly shifting priorities and challenges which may evolve as a result of local provincial issues or from various constraints imposed by national and international markets.

Though the general mandate of the agency will remain unchanged, the focus may be altered in favour of specific industries, at Government's direction, or through identifiable gaps which may emerge in commercial bank financing. With their singular objective of profitability and with policy decisions which are generally nationally directed, there will always be areas or gaps left by the banks that the agency will be needed to fill.

As the province's primary lending arm, the agency will undoubtedly continue to collaborate with other Government departments and corporations to structure financial programs to promote new development or to assist industry-specific difficulties. It continues to support the needs of our primary industries for capital purchases, expansion and operational expenses as well as encourages financing of non-traditional, potentially prosperous new enterprises.

The agency is unquestionably a higher-risk lender and often lender of last resort. Where any business can continue to demonstrate a potential for viability, the agency is generally supportive of providing assistance as it will maintain current employment while offering the operator the opportunity for recovery. This is a role the agency has historically provided and numerous businesses have been ultimately successful due to this support in difficult times. Also, differing from the commercial banks' profit requirement, the agency's mandate is to strive for a break-even operation. If this can be achieved, there are numerous benefits to the province, in various capacities, but no cost to the taxpayer for the service. By sustaining businesses and maintaining employment, it reduces the drain on already stressed provincial and federal support programs. In addition, revenue from business, personal and sales taxes is maintained. These are all valuable considerations and are weighed, along with various other factors, when decisions are made by agency staff.

Corporate Directory

The PEI Lending Agency was established to provide both term and working capital loans to eligible borrowers in the following sectors:

Small Business

Definition – Small business includes any person who:

(i) *carries on business, or intends to carry on business, in the province;*

(ii) *purchases a finished product from a supplier and resells that product without alteration;* and

(iii) does not employ more than 100 employees; or

(iv) did not have annual gross sales exceeding $10 million in the fiscal year immediately preceding an application made pursuant to Section 9 of the act.

This program is designed to meet the special needs of the Island's small business community and entrepreneurs for business acquisitions, expansions and debt consolidation.

Agriculture

Definition – Agriculture includes any person who:

(i) *carries on business, or intends to carry on business, in the province;*

(ii) owns or will acquire farm assets with the loan proceeds pursuant to the act or the regulations; and

(iii) is actively engaged in farming or intends to work actively at producing farm products.

It is the objective of the agency to encourage increased production of both established and new variety agricultural products, as well as, improved marketing facets and techniques for PEI agricultural products. This may include better storage, handling, grading and packaging facilities.

Tourism

Definition – Tourism includes any person who:

(i) *carries on business, or intends to carry on business, in the province; and*

(ii) operates a business, other than a Bed & Breakfast establishment as defined in the Tourism Industry Act Regulations (EC267/99), that holds a valid tourism establishment licence issued pursuant to the Tourism Industry Act Regulations.

Projects to expand the shoulder tourist season and development of integrated recreational complexes which would feature entertainment facilities, lodging and dining facilities are encouraged. In some cases, loans may be granted for accommodation units which are converted to other uses during off-season periods.

This program is designed to meet the special needs of Island tourism operators for business acquisitions, expansions and debt consolidation, refurbishment of fixed assets and in some cases working capital for seasonal startup.

Bed & Breakfast operations, as defined by the *Tourism Industry Act* Regulations, are ineligible to borrow from the agency.

Manufacturing and Processing

Definition – Manufacturing and processing includes any person who:

(i) *carries on business, or intends to carry on business, in the province; and*

(iii) operates a business which produces a product by mechanical method from a raw material that is altered to add value.

Loans are available to finance land and buildings, specialized equipment, and in some cases, production inventory.

Fisheries and Aquaculture

Definition – Fisheries and Aquaculture includes any person who:

(i) *carries on business, or intends to carry on business, in the province; and*

(ii) is licensed or qualified to obtain a licence or aquaculture permit issued by the federal Department of Fisheries and Oceans, for any of the commercial fisheries or aquaculture industries in the province.

The objective of the agency is to provide term financing, recapitalization and operating lines of credit to assist applicants in the commercial fishery and/or aquaculture industry. The agency takes a particular interest in supporting projects that have a potential commercial viability for under-exploited species of finfish, shellfish and sea plants.

Information Technology

Definition – Information technology includes any person who:

(i) *carries on business, or intends to carry on business, in the province; and*

(ii) operates a business that derives at least 60 per cent of revenue from software publishing, computer systems design and related services, the provision of online information services, or the manufacture of computer and peripheral equipment or related electronic components.

The objective of the agency is to provide term financing and operating lines of credit to assist borrowers purchasing fixed assets and for production and marketing expenses.

Aerospace

Definition – Aerospace includes any person who:

(i) carries on business, or intends to carry on business, in the province;

(ii) owns or will acquire assets of an aviation or aerospace-related business with loan proceeds received pursuant of the act or the regulations; and

(iii) is actively engaged in or intends to work actively in an aviation or aerospace-related business.

Year in Review

The year ending March 31, 2005, presented numerous challenges for the Lending Agency and its staff. PEI's primary industries once again experienced their share of difficulties. Potato growers witnessed low prices, despite having an excellent crop, due primarily to an oversupply in the industry. This left many growers with the inability to fully repay operating lines. To accommodate, in many instances, the agency was able to assist those affected by replenishing working capital through a refinancing of their long-term debt. Hog producers also continued to suffer from low market prices. We remain optimistic, however, that this won't persist as a long-term problem for the industry. It is our hope that minimal disease facilities and the Island's reputation for producing high quality pork will eventually translate into a higher demand for local product. Should demand increase, prices paid by the processors to the producers should also increase.

Problems continued to plague the fisheries sector with a significant reduction in landings reported along the Northumberland Strait. At year-end, the Department of Agriculture, Fisheries and Aquaculture together with the PEI Fisherman's Association, were exploring a number of options to assist these affected fishers. In the interim, the agency has re-written a number of affected fishermen's loans, capitalizing interest arrears and providing, in some cases, additional capital to assist with general expenses.

Requests for assistance from tourist operators have remained relatively steady. Just prior to and following opening of the Confederation Bridge, financing requests escalated for new construction or expansion to existing fixed-roof accommodations in response to the boom in visitation growth experienced during this time. With an eventual leveling out and subsequent decrease in visitation, the market, understandably, quickly reached a saturation point. Therefore, during the 2004 tourist season, the agency saw very few like requests. Alternatively, what the agency finds at this time is a need by operators to upgrade older establishments in response to current consumer demand for mid- to high-end lodgings.

At year-end, the agency's loan arrears, when expressed as a percentage of the total portfolio, equated to 7.6 per cent which is an increase from 6.4 per cent at March 31, 2004. The total outstanding balance owing on these accounts, as a percentage of the total portfolio, equated to 15 per cent, or $21.6 million. These arrears figures would be distributed over 110 of the agency's 537 clients. It should be noted that these figures include loans which have matured and, for one reason or another, may not have been renewed by year's end. In those cases, the entire outstanding balance would be shown in arrears. Also, these figures include non-current accounts, whereby the entire loan balance is shown as the arrears amount, rather than the actual payments outstanding, due to the risk level.

For the period ending March 31, 2005, there was a significant increase in the non-interest categories of service fees, post-receivership income and the gain on sale of property. However, the decrease year-over-year in interest revenue, of a little over $1.2 million, resulted in the agency falling short of its total forecasted revenue by $1,046,000, before the grant from the province is applied. This lost revenue can be attributed to a decrease in the agency's total loan portfolio, by approximately $9 million, and the reduction in loan numbers from 685 in March 2004 to 610 by the end of March 2005. The net effect, being the difference in interest revenue less interest expense, equated to a loss of approximately $250,000.

The annual grant from the province, as noted above, is provided to help fund any operational shortfalls experienced by the agency. In addition to the lost interest revenue, a significant portion of this year's grant was needed to help offset the increase in the expense category for loan loss provision. For the information of the reader, the agency annually establishes a provision for possible loan losses which is an estimate of potential losses, on doubtful or high risk loans, in the event of a distressed situation. This allowance is determined by calculating what the assets pledged may realistically realize upon disposal, against what is outstanding on those identified loans. During the budget process, the loan loss provision was established at $1,626,245. However, during completion of the agency's annual audit and year-end financial statements, the external auditors determined the provision required an increase of a further $2,702,76 to cover possible doubtful or high-risk accounts.

The decrease in forecasted revenues, combined with the needed increase to the loan loss provision, resulted in the requirement of a $2,690,000 increase in the grant from the province, in order to achieve a break-even position.

In comparing the budgeted operating expenses, before loan loss provision and interest expenses, the agency forecasted operating expenses to be $1,097,355. This represented a year-over-year increase of $20,688, which was simply an estimated inflationary increase of two per cent. Actual expenses incurred amounted to $1,070,282, or $27,073 under budget. Once again the largest single contributing expense category remains interest paid to the province on borrowed funds. This expense was down approximately $1 million year-over-year, and as mentioned earlier, it is offset by the interest from borrowers. Management continues to monitor this expense very closely to ensure that a sufficient interest spread on its funds borrowed is maintained.

The actual loan losses experienced by the agency over the period of this report was $4,842,218. By sector, these losses are broken down as follows: $3.6 million on agricultural loans, including hog and blueberry production; $410,000 in the manufacturing sector; and the remaining $842,000 can be attributed to losses in the cultured oyster fishery.

Manufacturing and Processing

The manufacturing and processing sector of the economy continues to be a strong economic driver providing skilled labour, sourcing revenues from predominantly off-Island markets, while local suppliers fulfil export demand. The result is that this sector is a net contributor to the province's gross domestic product. While the past year has seen a continued strengthening of the Canadian currency against the US dollar, local firms have had to enhance marketing initiatives to secure contracts and seek hedging plans to mitigate the risks of foreign exchange loss.

Demand in this sector is strong, and the services provided by this Agency continue to foster manageable growth. However, this growth is primarily derived from the existing base of clients. Over this past year, 13 applications were received

for loans, totaling $5,025,000, of which $3,775,000 received funding approval. One of the applications was withdrawn and only one declined.

At year-end, the agency's loan exposure to this sector totalled $33,000,000, or 23 per cent of the entire portfolio. Clients in this sector typically borrow significantly more funds than most other industries, due to the intensive capital requirements of conducting trade. Of the agency's 593 clients at year-end, only six per cent of clients were involved in the manufacturing and processing sector.

Overall, the health of this segment of the agency's portfolio is above average.

Information Technology

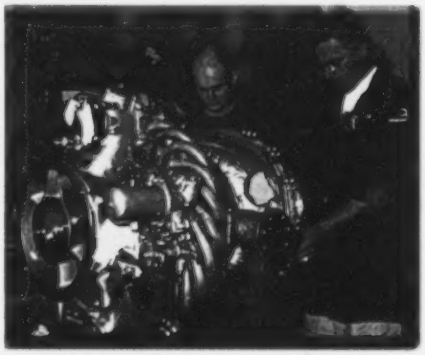
The agency has seen little activity in this sector during the period under review. This can be partially attributed to the fact that the ministry of Development and Technology, which has responsibility for the Atlantic Technology Centre, has taken a lead in the development of IT businesses. PEI Business Development Inc., a crown corporation under the ministry, has established a dedicated IT and loans group to assist these companies. Additionally, growth in the IT sector has slowed considerably over the last few years. The tremendous economic growth that was experienced by the industry, beginning in the mid-90s with many new start-ups and products, has leveled out considerably over the past few years.

It continues to be a challenge for businesses involved in the IT sector to obtain financing when in the early stages of development, before products are at a marketable state. Conventional lenders, on behalf of their stakeholders, seek investment opportunities that pose a low level of risk, offering acceptable returns on their money. It is difficult for many to acquire a level of comfort when borrowed funds will be used to finance concepts, developmental costs and fixed assets comprised of computers and software – items with little or no resaleable value. Without access to monetary inputs through personal sources or an "Angel" investor, operating capital needs often tend to be met on the strength of future tax credits that can be assigned as security in support of the financing.

The agency had investments totaling $1,470,108 at year-end, representing only five clients. Over the past year, the agency received three applications for loans totaling $275,000, of which two were approved and one was declined.

Aerospace

The aerospace industry, like the manufacturing industry, provides highly skilled labour deriving most revenues from off-Island markets. This segment of the Island's economy is enjoying much success coupled with the present tax holiday operating in Slemon Park, PEI. The agency deals with companies involved in the mass transit industries involving the maintenance, repair and overhaul of fixed-wing aircraft as well as those manufacturing sub-assembly materials for the construction of trains and aircraft.



This segment represented $17,741,000 or 12.3 per cent of the agency's entire loan portfolio at year-end. Like the manufacturing industry, there are few clients involved, representing only 0.3 per cent of the total loan portfolio.

Over the past year, the agency received no new applications from clients involved in this industry. Overall, the agency's investments into this sector have aided in the continued growth of this industry with the risk of investment improving each year.

Tourism

During the period of this report, the Lending Agency received 16 loan applications, representing $12.7 million in assistance, from businesses within this sector of the economy. Approximately 50 per cent of those applications were for debt consolidation purposes, while 25 per cent were for renovations and expansion and a further 19 per cent for new purchases. Eleven of the applications received approvals, representing $11.3 million.

Though the agency experienced a year-over-year reduction in the number of applications by three, there was an increase in the amount of financing requested by $3.4 million. There was also an increase in the amount of approved loans this year over last by $7.9 million, bringing the total tourism portfolio currently to $25.4 million. Although this represents an increase in the size of the portfolio by 58 per cent over the previous year, it should be noted that a $9.1 million application, booked prior to year-end, significantly impacted the year-end results.

With a steady decline in tourism visitation over the past few years, it is understandable that the number of financing requests would also decline. The attraction of the "Confederation Bridge experience," which initially increased tourism numbers significantly, may have begun to fade. It should also be recognized that events of September 11, 2001, which impacted American visitation nationally, likely impacted our local region as well. In 2004 visitation to PEI declined by 13 per cent over the previous year – down from 1.105 million visitors in 2003 to just under one million in 2004. There was also a decrease in tourism spending experienced in 2004, undoubtedly due to the reduced visitation. According to Department of Tourism information, tourism spending dropped 16 per cent, year-over-year, from $345 million in 2003 to $292 million in 2004. Unfortunately this drop in spending has created cash flow problems for some Island operators.

As of March 31, 2005 there were five clients in arrears with $323,000 in past due payments and one client in non-current, with an outstanding balance of $285,936. This compares to five clients in arrears with outstanding payments of $151,000 at March 31, 2004.

Management is anticipating a minor decrease in the dollar value of applications for the coming year.

Small Business

The agency's Small Business portfolio consists of a wide variety of businesses; generally any commercial enterprise that doesn't classify under the specific descriptions of the other economic sectors, would be identified under the Small Business sector.

During the period under review, the agency witnessed a reduction in activity within this sector. Of 13 applications received, representing $2.53 million, 12 of these were approved for a total of $2.5 million. Approximately 62 per cent of the applications received were for the purchase of capital assets and the remaining 38 per cent were for debt consolidation. Compared to the prior year, there was a decrease in the number of applications by seven and a decrease in the total dollar value requested by $800,000. However, despite this reduction in requests, the actual portfolio saw an increase over the previous year by 6.2 per cent, with a total outstanding balance of $12.7 million at year-end.

It is worth note that, due to the small size of most Island businesses, their financial requirements can usually be met by local chartered banks with little or no risk to the bank itself. With changes introduced a number of years ago to the *Small Business Loans Act*, chartered banks are able to provide financing of up to $250,000 under a program that guarantees those loans by the federal government. This has a significant impact on the number of small business applications received by the agency at the current time.

At March 31, 2005, there were eight clients in arrears with $24,202 owing in past-due payments, compared to seven clients with $65,460 owing at the same time last year. There were also eight clients listed in the non-current status at year-end, with outstanding balances totaling $955,530. This compares to seven clients in non-current, with outstanding balances totaling $1,074,548 at March 31, 2004.

The agency anticipates a small increase in the dollar value of applications from this sector in the coming year.

Fisheries and Aquaculture

In fiscal year 2004/2005, 17 applications were received for a total of $2.7 million in requested financing. Of those applications, 16 were approved for a total of $2.6 million. The one remaining application was withdrawn. This represents a decline of five applications received over the previous year, however it is an increase of $0.7 million in requested financing over the same period.

Of the applications approved, five represent working capital loans to mussel farming operations. The remaining 12 loans were for term financing to purchase vessels, equipment, fishing enterprises and/or for debt consolidation. Ten of these loans were provided to traditional fisheries clients and two were to mussel farmers.

The fisheries and aquaculture portfolio of clients decreased from 104 to 94 year-over-year, resulting in our total investment in this sector decreasing from $11.7 million to $11.1 million.

As first identified in the year 2000, the agency's oyster farm clients began experiencing significant problems with predators. Their chances for

success were further complicated by problems beyond their control, including severe kill during the winter/spring of 2002/2003 due to extreme ice conditions.

The agency's oyster farm portfolio consisted of clients provided financing under the Shellfish Aquaculture Program, a joint project with the provincial Department of Agriculture, Fisheries and Aquaculture which was first offered in 1996. This program, aimed at establishing an oyster industry, once peaked at 28 clients and had a portfolio over of $5 million. It has since been significantly reduced, with only eight clients remaining and with a portfolio balance of less than $1 million at March 31, 2005. Of those accounts remaining on the books of the agency, less than $200,000 would be classified in the current category.

The balance of problem accounts continue to be dealt with on an individual basis either through settlement proposals and/or filings under bankruptcy. Provisions for losses have been provided for these cases.

The traditional lobster fishery in the Northumberland Strait, including both spring and fall seasons, continues to experience reduced landings. Once again, this has resulted in Agency staff working closely with affected fishers in renegotiating repayment terms, wherever possible. This was completed through evaluation, on a case-by-case basis. Both the industry and government representatives are working toward identifying the cause behind the reduction in stocks, in an effort to improve the situation. Agency staff will continue to monitor this situation closely. It is hoped the Northumberland Strait fishery will see its lobster landings return to levels which will allow for the viability of enterprises in this zone. Should the decline continue, it will have a major impact on the agency's fisheries portfolio with 36 of 94 clients fishing in this area.

The Gulf of St. Lawrence lobster fishery remains healthy with landings increasing from previous years.

Agriculture

The PEI Lending Agency continues to play a significant role in providing financing to the agricultural sector. Agricultural loans outstanding account for 27 per cent of the total lending portfolio, while accounting for approximately 50 per cent of the agency's entire number of clients. At year-end 2005, aggregate loans to this sector totaled $38.8 million; an increase of $2.7 million over 2004. Working Capital Loans totaled $17.8 million, up $1.0 million, and capital loans totaled $21.0 million, up $1.7 million over the previous year.
Overall, 95 applications were approved, of which 87 were for working capital purposes. Working capital loans to clients in the potato industry represent some of the larger individual accounts.

It is highly unusual to have the three main sectors of agriculture experiencing difficulties (potatoes, hogs and beef) at the same time, unfortunately the 2004 season was similar to that of 2003. Though the 2004 season was another excellent growing year, potato farmers again experienced one of the poorest years on record due to an oversupply of potatoes, combined with depressed markets. The surplus production has resulted in working capital shortfalls for many producers which has prompted many of those with sufficient equity to approach their financial

institutions for debt restructuring and consolidation. It has also resulted in the agency continuing to receive requests for financing which was traditionally provided by banks and credit unions but who are now unable to provide their support, in many cases.

The hog industry continues to experience price volatility, but in 2004 market prices were better than 2003, overall. As with other provinces, there is a continuing trend toward larger consolidated operations to realize better economies of scale requiring substantial increases in financing. The agency continues to administer a portfolio of loans previously approved under several programs initiated by the Department of Agriculture, Fisheries and Aquaculture that were cancelled during the year under review.

As a direct result of the discovery of BSE (mad cow disease) in May of 2003, the USA closed its border to Canadian beef which resulted in a downturn in the industry for the last two years. The opening of the new processing plant in Borden in the fall of 2004 has assisted the local market, although the plant is not yet operating at capacity. The US border has since re-opened, and shipments to that market should result in a gradual return to more traditional sales levels for Island farmers. The agency will continue to work with its existing beef clients where there is deemed to be long-term viability.

The blueberry industry on PEI has become a significant industry with a harvest of 8.4 million pounds in 2004, up one million pounds over 2003. Overall, it was a good growing season with higher yields as previously developed land continues to mature, and newly developed acreage is coming into production. Loans to developers were previously provided under the Blueberry Assistance Program and at renewal, the Department of Agriculture, Fisheries and Aquaculture provides interest assistance for two years on the original amount borrowed. Approximately half of the loans outstanding under the program have received this interest relief and are now accountable for repayment from their cash flow. Unfortunately some operations were not able to develop their land and reach full production in the time that was originally anticipated, and in some cases revenues will not be sufficient to meet debt servicing requirements. The agency will work with these clients on an individual basis, and will request assistance from the berry specialist at the Department of Agriculture, Fisheries and Aquaculture if needed.

The cranberry industry in PEI is still very small, however, production is increasing annually with a harvest of 320,000 pounds in 2004 compared to 290,000 pounds in 2003. Producers formed a growers' association who continue to work together in hopes of securing a long-term market presence and increased market price. Interest assistance is also being provided to cranberry growers by the Department of Agriculture, Fisheries and Aquaculture.

Supply-managed commodities such as dairy, eggs and poultry have not experienced the same financial difficulties as those engaged in non-supply managed commodities. Portfolio exposure to these particular industries is not extensive.

The agency continues to work closely with existing farm clients who have experienced difficulties in their respective industries, and will continue to support viable operations. During the past year, we have seen a trend toward restructuring existing loans to relieve some of the pressure associated with the downturn in the farming industry as a whole.

Compte rendu de l'année

L'exercice qui s'est terminé le 31 mars 2005 a présenté de nombreux défis pour l'Agence et son personnel. Encore une fois, les industries du secteur primaire de l'Î.-P.-É. ont toutes eu plus que leur part de difficultés au cours de l'exercice. Les producteurs de pommes de terre, qui ont obtenu une excellente récolte, ont été confrontés à la faiblesse des prix, phénomène surtout attribuable à la surproduction de l'industrie. De nombreux producteurs ont ainsi été incapables de rembourser entièrement leur marge de crédit. L'Agence est venue en aide à bon nombre d'entre eux en reconstituant le fonds de roulement par le refinancement des dettes à long terme. Les éleveurs de porcs ont aussi continué à subir la faiblesse des prix du marché. On ne croit pas toutefois que ce problème persiste à long terme. On espère que le faible nombre d'installations touchées par la maladie et la réputation dont jouit l'Île dans la production de porc de grande qualité finira par accroître la demande à l'égard du produit d'ici. Dans ce cas, les prix payés par les transformateurs aux éleveurs devraient augmenter.

La situation est toujours difficile dans le secteur des pêches, comme en témoigne la baisse importante des prises débarquées sur les côtes du détroit de Northumberland. À la fin de l'exercice, le ministère des Pêches, de l'Aquaculture et de l'Environnement, de concert avec la PEI Fisherman's Association, envisageaient différentes façons d'aider les pêcheurs concernés. Pour le moment, l'Agence a révisé les prêts d'un certain nombre de pêcheurs; elle a notamment capitalisé les intérêts en souffrance et accordé, dans certains cas, des fonds supplémentaires pour aider à couvrir les frais généraux.

Le nombre de demandes d'aide des exploitants touristiques est demeuré assez stable. Juste avant et après l'inauguration du pont de la Confédération, qui a entraîné une hausse spectaculaire de la fréquentation touristique, on a constaté une montée en flèche des demandes de financement concernant la construction ou l'agrandissement d'établissements d'hébergement en dur. Cependant, comme le nombre de visiteurs a fini par plafonner et même diminuer, le marché est parvenu rapidement à un point de saturation. C'est pourquoi l'Agence a reçu très peu de demandes en ce sens au cours de la saison touristique 2004. Elle note plutôt en ce moment un besoin, pour les exploitants, de moderniser les établissements vieillissants en réponse à la demande d'hébergement de milieu de gamme à haut de gamme.

À la fin de l'exercice, les prêts en souffrance représentaient 7,6 % du nombre total de prêts au portefeuille de l'Agence. Au 31 mars 2004, ce pourcentage était de 6,4 %. Le total du solde impayé de ces prêts, par rapport à l'ensemble du portefeuille, équivalait à 15 %, soit 21,6 millions de dollars. Les montants d'arrérages concernent plus de 110 des 537 clients de l'Agence. Il faut cependant préciser que ces données comprennent les prêts qui ont échu et qui, pour une raison ou pour une autre, n'ont pas été renouvelés avant la fin de l'exercice. Dans ces cas, le montant total

des soldes impayés apparaît dans les arrérages. Les données comprennent également les prêts non courants, pour lesquels le montant entier du solde s'affiche comme arrérage plutôt que comme paiement réel en souffrance, étant donné le niveau de risque.

On constate, au cours de la période se terminant le 31 mars 2005, une hausse importante dans certaines catégories non productives d'intérêts : frais de service, revenu découlant de la mise sous séquestre et gains liés à la vente de biens. Cependant, la diminution par rapport à l'exercice précédent du revenu en intérêts, qui a dépassé légèrement les 1,2 million de dollars, a fait que l'Agence a affiché un revenu total de 1 046 000 $ inférieur à ce qui était prévu, avant application de la subvention provinciale. Ce manque à gagner peut être imputé à une baisse d'environ 9 millions de dollars dans le portefeuille de prêts de l'Agence et à la réduction du nombre de prêts de 685, en mars 2004, à 610, à la fin de mars 2005. L'effet net, c'est-à-dire l'écart entre le revenu en intérêts et les frais d'intérêts, représente une perte d'environ 250 000 $.

La subvention annuelle de la province, comme il est noté ci-dessus, aide à combler les manques à gagner constatés dans les activités de l'Agence. Outre la perte de revenu en intérêts, une bonne part de la subvention de cet exercice a été utilisée pour compenser l'augmentation des dépenses liées à la provision pour pertes sur prêts. À titre d'information, l'Agence établit annuellement une provision pour les pertes sur prêts éventuelles, qui consiste en une estimation des pertes possibles découlant des prêts douteux ou à risque élevé, dans les cas de prêt en difficulté. On détermine ce montant en calculant le produit réaliste de la vente des actifs gagés par rapport aux arrérages des prêts visés. Au cours de l'établissement du budget, la provision pour pertes sur prêts a été fixée à 1 626 245 $. Cependant, lors de la vérification annuelle et de la production des états financiers de fin d'exercice de l'Agence, les vérificateurs externes ont déterminé qu'il fallait majorer la provision de 2 702 760 $ afin de tenir compte d'éventuels prêts douteux ou à risque élevé.

Étant donné la baisse du revenu prévu et la majoration requise de la provision pour pertes sur prêts, l'Agence doit compter sur une augmentation de 2 690 000 $ de la subvention provinciale afin d'atteindre le point mort.

Par comparaison aux dépenses d'exploitation établies dans le budget (avant provision pour pertes sur prêts et frais d'intérêt), l'Agence a prévu des dépenses d'exploitation de 1 097 355 $. Cette somme représente une hausse de 20 688 $ par rapport à l'exercice précédent, et correspond tout simplement à une augmentation estimée de 2 % du taux d'inflation. Les dépenses réelles se sont élevées à 1 070 282 $, soit 27 073 $ de moins que le montant prévu au budget. Ici encore, les intérêts versés à la province à l'égard des fonds empruntés forment la principale catégorie de dépense. Ce type de dépense a toutefois diminué d'environ 1 million de dollars par rapport à l'exercice précédent et, comme il a déjà été précisé, il est compensé par les intérêts reçus des emprunteurs. La direction continue de surveiller cette catégorie de dépense très étroitement afin d'assurer le maintien d'une marge d'intérêt suffisante à l'égard des fonds empruntés.

Les pertes sur prêts réelles subies par l'Agence au cours de la période à l'étude ont été de 4 842 218 $. Elles se répartissent de la façon suivante selon les secteurs : 3,6 millions pour l'agriculture, dont l'élevage de porcs et la production de bleuets, 410 000 $ pour la fabrication, et les 842 000 $ restants pour l'ostréiculture.

Fabrication et transformation

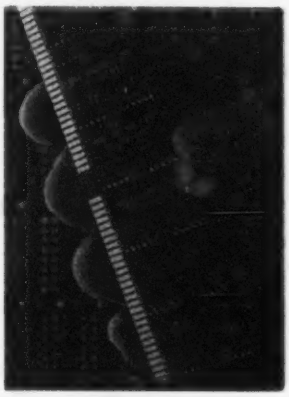
Le secteur de la fabrication et de la transformation demeure solide : il crée des emplois qualifiés et génère des recettes à partir de marchés situés surtout à l'extérieur de l'Île, tout en permettant aux fournisseurs d'ici de répondre à la demande d'exportation. Il s'affiche ainsi comme un contributeur net au produit intérieur brut de la province. Dans une année où le dollar canadien a poursuivi sa hausse par rapport au dollar américain, les entreprises locales ont dû intensifier leur travail de marketing afin d'obtenir des contrats et se doter de plans de couverture pour réduire les risques posés par la force du dollar canadien.

La demande dans le secteur demeure forte, et les services de l'Agence continuent d'aider les entreprises à bien gérer leur croissance. Cependant, cette croissance repose principalement sur la clientèle existante. Au cours du dernier exercice, l'Agence a reçu 13 demandes de prêt totalisant 5 025 000 $. La valeur des demandes approuvées s'est alors élevée à 3 775 000 $. Une demande a été retirée et une seule a été rejetée.

À la fin de l'exercice, la valeur des prêts accordés par l'Agence à ce secteur totalisait 33 000 000 $, soit 23 % du portefeuille. Les clients de ce secteur empruntent habituellement plus que les autres industries, étant donné les sommes importantes qu'exige le commerce. Sur les 593 clients de l'Agence dénombrés à la fin de l'exercice, seulement 6 % s'occupaient de fabrication et de transformation.

Dans l'ensemble, ce segment du portefeuille de l'Agence affiche une santé supérieure à la moyenne.

Technologie de l'information



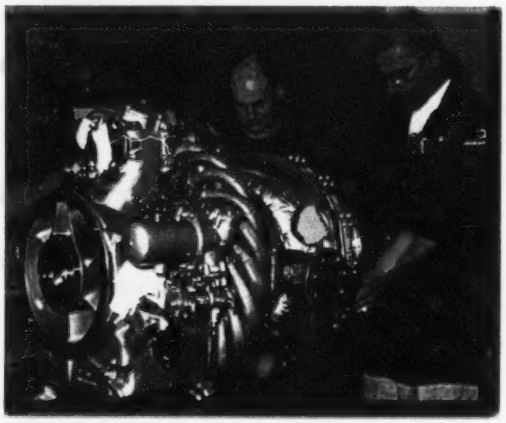
L'Agence a observé peu d'activité dans ce secteur au cours de la période examinée. Cette situation peut être attribuée en partie au fait que le ministère du Développement et de la Technologie, responsable de l'Atlantic Technology Centre, a pris l'initiative du développement des entreprises de TI. L'organisme PEI Business Development Inc, une société d'État relevant du ministère, a établi un groupe chargé de la TI et de l'octroi de prêts afin d'appuyer ces entreprises. Par ailleurs, la croissance du secteur de la TI a ralenti considérablement ces dernières années. L'essor remarquable pris par l'industrie à partir du milieu des années 1990, époque qui a vu naître tant d'entreprises et de produits, s'est grandement stabilisé.

Il est toujours difficile, pour les entreprises de TI, d'obtenir du financement dans les premières étapes du développement d'un produit, avant que celui-ci soit commercialisable. Les prêteurs traditionnels, qui agissent au nom des parties intéressées, recherchent des possibilités d'investissement qui présente à la fois un faible risque et un rendement acceptable. Bon nombre d'entre eux hésitent à prêter de l'argent qui servira à financer des concepts, des coûts de développement et des actifs immobilisés composés d'ordinateurs et de logiciels - lesquels ont une valeur de revente faible ou nulle. Lorsqu'ils ne peuvent tirer profit de leurs sources personnelles ou de l'apport d'un investisseur providentiel, les entrepreneurs comblent souvent leurs besoins en fonds d'exploitation en se fiant aux crédits d'impôt futurs qui peuvent être mis de l'avant comme valeur à l'appui du financement.

À la fin de l'exercice, les investissements de l'Agence dans le secteur de la TI totalisaient 1 470 108 $ et ne concernaient que cinq clients. L'Agence a reçu au cours de l'exercice trois demandes de prêt d'une valeur totale de 275 000 $. Deux ont été approuvées, et une a été rejetée.

Aérospatiale

Tout comme le secteur de la fabrication, l'industrie aérospatiale crée des emplois



hautement qualifiés et génère la majeure partie de ses recettes à partir de marchés situés à l'extérieur de l'Île. Ce secteur de l'économie provinciale vit de beaux jours, notamment en raison du congé fiscal en vigueur à Slemon Park. L'Agence fait affaire avec des entreprises de l'industrie du transport public, qui s'occupent par exemple de l'entretien, de la réparation et de la révision des aéronefs à voilure fixe, ou encore de la fabrication de pièces de sous-ensemble servant à la construction de trains et d'aéronefs.

L'aérospatiale comptait pour 17 741 000 $, ou 12,3 %, du portefeuille de prêts de l'Agence à la fin de l'exercice. Comme dans le cas de la fabrication, on dénombre peu de clients. En effet, ceux-ci ne représentent que 0,3 % du portefeuille.

Au cours du dernier exercice, l'Agence n'a reçu aucune nouvelle demande des entreprises de cette industrie. En général, les investissements de l'Agence ont aidé le secteur à poursuivre sa croissance. Le risque diminue d'ailleurs d'un exercice à l'autre.

Tourisme

Au cours de la période examinée, l'Agence a reçu 16 demandes de prêt d'exploitants touristiques. La valeur de ces demandes a totalisé 12,7 millions de dollars. Près de 50 % d'entre elles visaient la consolidation de dette, 25 % concernaient des projets de rénovation et d'agrandissement, et 19 % avaient trait à des achats. L'Agence a approuvé 11 demandes dont la valeur totale a atteint 11,3 millions de dollars.

Même si le nombre de demandes reçues par l'Agence a été le tiers de celui de l'exercice précédent, la somme du financement demandé a augmenté de 3,4 millions de dollars. On a aussi observé que la valeur des prêts approuvés s'était accrue de 7,9 millions de dollars, ce qui a porté la valeur totale du portefeuille de tourisme à 25,4 millions. Il s'agit d'une augmentation de 58 % en un an, mais il faut noter qu'une demande de 9,1 millions de dollars, comptabilisée avant la fin de l'exercice, a eu un effet important sur les résultats finals.

Compte tenu de la baisse graduelle de la fréquentation touristique au cours des dernières années, il est normal que le nombre de demandes de financement diminue. L'attrait du pont de la Confédération, qui a, au départ, entraîné une hausse considérable de la fréquentation, s'est probablement atténué. Il faut également reconnaître que les attaques terroristes du

11 septembre 2001 ont eu un impact sur le nombre de visiteurs en provenance des États-Unis à l'échelle nationale, et donc à l'Île aussi. De 2003 à 2004, le nombre de visiteurs à l'Île est passé de 1,105 million à un peu moins de 1 million, soit une baisse de 13 %. La valeur des dépenses touristiques a aussi diminué en 2004, phénomène sans doute attribuable à la baisse de la fréquentation. Selon les données du ministère du Tourisme, ces dépenses sont passées de 345 à 292 millions de dollars entre 2003 et 2004, une chute de 16 %. Cette baisse a malheureusement causé des difficultés financières pour un certain nombre d'exploitants de l'Île.

Au 31 mars 2005, cinq clients affichaient des paiements en souffrance de 323 000 $, et un client avait un prêt non courant montrant un solde impayé de 285 936 $. Par comparaison, au 31 mars 2004, cinq clients affichaient des paiements en souffrance de 151 000 $.

La direction s'attend à ce que la valeur des demandes à recevoir de ce secteur au cours de l'année à venir diminue légèrement.

Petite entreprise

Le portefeuille de l'Agence relatif à la petite entreprise touche un large éventail d'entreprises; en général, toute entreprise commerciale qui ne relève pas des secteurs économiques déjà établis est classée dans ce portefeuille.

Au cours de la période à l'étude, l'Agence a constaté une baisse de l'activité dans ce secteur. Parmi les 13 demandes reçues, qui totalisaient 2,53 millions de dollars, elle en a approuvées 12, dont la valeur s'élevait à 2,5 millions. Environ 62 % des demandes concernaient l'achat d'actifs immobilisés, tandis que les 38 % restants visaient la consolidation de dette. Par comparaison à l'exercice précédent, le nombre de demandes a diminué de sept, et leur valeur, de 800 000 $. Cependant, la valeur réelle du portefeuille a quand même augmenté de 6,2 % en un an. À la fin de l'exercice, le total du solde impayé atteignait 12,7 millions de dollars.

Il convient de noter que, étant pour la plupart de petite taille, les entreprises de l'Île peuvent habituellement combler leurs besoins financiers en s'adressant à la banque à charte de leur localité, pour laquelle le risque est faible ou nul. En effet, à la suite des modifications apportées il y a quelques années à la *Loi sur les prêts aux petites entreprises*, un programme du gouvernement fédéral garantit les prêts d'un maximum de 250 000 $ octroyés par les banques à charte. Ce programme a un effet important sur le nombre de demandes que l'Agence reçoit actuellement des petites entreprises.

Au 31 mars 2005, huit clients affichaient des paiements en souffrance de 24 202 $, et huit clients avaient des prêts non courants totalisant un solde impayé de 955 530 $. Par comparaison, au 31 mars 2004, sept clients affichaient des paiements en souffrance de 65 460 $, et sept clients avaient des prêts non courants totalisant un solde impayé de 1 074 548 $.

L'Agence s'attend à ce que la valeur des demandes à recevoir de ce secteur au cours de l'année à venir augmente légèrement.

Pêche et aquaculture

Au cours de l'exercice 2004-2005, l'Agence a reçu 17 demandes de financement totalisant 2,7 millions de dollars. Elle en a approuvées 16, dont la valeur totale s'élevait à 2,6 millions de dollars. L'autre demande a été retirée avant qu'une décision soit rendue. Par rapport à l'exercice précédent, le nombre de demandes a diminué de cinq, mais leur valeur a augmenté 0,7 million de dollars.

Cinq des demandes approuvées ont été accordées en prêts de fonds de roulement à des entreprises de mytiliculture. Les 12 autres demandes concernaient du financement à terme pour l'achat de bateaux, d'équipement, d'entreprises de pêche et/ou la consolidation de dette. Dix de ces prêts ont été consentis à des clients de la pêche traditionnelle et deux, à des mytiliculteurs.

Le portefeuille de la clientèle de la pêche et de l'aquaculture a diminué, étant passé de 104 à 94 clients par rapport à l'année précédente. L'investissement total de l'Agence dans ce secteur est ainsi passé de 11,7 à 11,1 millions de dollars.

Comme il avait été révélé pour la première fois en l'an 2000, les clients de l'Agence pratiquant l'ostréiculture éprouvent un grave problème de prédation. Or, il s'avère que ces entrepreneurs sont confrontés à d'autres difficultés indépendantes de leur volonté, notamment une mortalité massive à la suite de mauvaises conditions des glaces à l'hiver et au printemps de 2002-2003.

Le portefeuille d'ostréiculteurs de l'Agence se compose de clients financés dans le cadre du Shellfish Aquaculture Program, mis en oeuvre conjointement avec le ministère des Pêches, de l'Aquaculture et de l'Environnement de la province et offert pour la première fois en 1996. Ce programme, qui vise à établir une industrie ostréicole, a regroupé, à une certaine époque, 28 clients qui formaient un portefeuille de plus de 5 millions de dollars. Il est aujourd'hui beaucoup plus restreint : au 31 mars 2005, il ne comptait plus que 8 clients et son portefeuille valait moins de 1 million de dollars. Parmi les comptes toujours inscrits aux livres comptables de l'Agence, ceux qui sont courants représentent moins de 200 000 $ en valeur.

Le traitement des comptes-problèmes se poursuit au cas par cas, que ce soit par le biais d'une proposition de règlement et/ou du dépôt de bilan. L'Agence a prévu des provisions pour pertes sur prêts à l'égard de ces clients.

Le secteur de la pêche du homard traditionnelle subit toujours une diminution des prises débarquées dans le détroit de Northumberland, aussi bien au printemps qu'à l'automne. Encore une fois, l'Agence a été amenée à renégocier les modalités de remboursement des pêcheurs concernés, dans la mesure du possible, ce qui s'est fait au moyen d'une évaluation au cas par cas. Afin d'améliorer la situation, des représentants de l'industrie et du gouvernement tentent de cerner les facteurs provoquant la diminution des stocks. L'Agence continuera de surveiller la situation étroitement. On espère que les prises de homard débarquées reviendront à des niveaux commercialement viables dans le détroit de Northumberland. L'aggravation de la réduction des stocks aurait un impact considérable sur le portefeuille des pêches de l'Agence, car 36 des 94 clients de ce secteur sont situés dans la région.

Sur la côte Nord de l'Île, dans le golfe du Saint-Laurent, la pêche du homard reste bonne, les prises débarquées étant en hausse par comparaison à l'exercice précédent.

Agriculture

L'Agence continue de jouer un rôle important dans le financement de l'industrie agricole. Les prêts en cours dans ce secteur englobent 27 % de l'ensemble du portefeuille de prêts et environ 50 % de la clientèle de l'Agence. À la fin de l'exercice 2005, le regroupement des prêts agricoles totalisait 38,8 millions de dollars, soit une augmentation de 2,7 millions par rapport à 2004. Les prêts de fonds de roulement s'élevaient à 17,8 millions, en hausse de 1 million, tandis que les prêts pour immobilisations ont atteint 21 millions de dollars, soit 1,7 million de plus qu'à l'exercice précédent.

L'Agence a approuvé 95 demandes, dont 87 pour le fonds de roulement. Les prêts de fonds de roulement accordés aux clients de l'industrie de la pomme de terre représentent certains des comptes individuels les plus importants.

Il est très rare que les trois grands secteurs de l'industrie agricole (pomme de terre, porc et boeuf) connaissent des difficultés en même temps, mais c'est bien ce qui s'est produit en 2004, tout comme en 2003. Même si la saison 2004 a encore une fois été excellente du point de vue de la récolte, les producteurs de pommes de terre ont enregistré une autre année exécrable en raison de la surproduction et de la faiblesse des marchés. La production excédentaire a entraîné pour beaucoup de producteurs une insuffisance de fonds de roulement. Bon nombre de ceux qui avaient suffisamment de capitaux propres ont ainsi été amenés à solliciter leur institution financière pour restructurer et consolider leur dette. Par ailleurs, l'Agence a continué de recevoir des demandes de financement qui étaient auparavant traitées par des banques ou des caisses populaires, lesquelles ne sont plus en mesure d'apporter leur aide, dans de nombreux cas.

L'industrie du porc continue d'être éprouvée par la volatilité des prix, mais ceux-ci ont, dans l'ensemble, été meilleurs en 2004 qu'en 2003. Comme dans d'autres provinces, la tendance favorise le regroupement des entreprises, qui permet de réaliser des économies d'échelle mais qui exige du financement beaucoup plus important. L'Agence continue d'administrer un portefeuille de prêts déjà approuvés dans le cadre de plusieurs programmes que le ministère de l'Agriculture et des Forêts avait lancés, mais qu'il a annulés au cours de l'exercice à l'étude.

À la suite de la découverte d'un cas d'ESB (la « maladie de la vache folle ») en mai 2003, les autorités américaines ont fermé la frontière au

boeuf canadien. Cette décision a grandement nui à l'industrie dans les deux dernières années. L'inauguration d'une usine de transformation à Borden à l'automne de 2004 a certes aidé le marché local, mais l'établissement ne fonctionne toujours pas à pleine capacité. Entre-temps, la frontière a été rouverte, et la reprise des exportations à destination du marché américain devrait se traduire par un retour graduel à des niveaux de vente auxquels les éleveurs de l'Île sont plus habitués. L'Agence continuera de travailler avec ses clients de l'industrie bovine qui semblent aptes à parvenir à la viabilité à long terme.

L'industrie du bleuet revêt aujourd'hui une grande importance à l'Île, comme en fait foi la récolte de 8,4 millions de livres en 2004, en hausse de 1 million de livres par rapport à 2003. Dans l'ensemble, la saison a été bonne, les terres déjà cultivées étant plus mûres et les surfaces nouvellement aménagées étant arrivée au stade de production. Les prêts aux responsables des projets d'aménagement ont été octroyés dans le cadre du Blueberry Assistance Program. Au renouvellement, le ministère de l'Agriculture et des Forêts offre une aide pour le paiement des intérêts sur le montant original emprunté pendant une période de deux ans. La moitié environ des clients qui ont obtenu un prêt dans le cadre du programme ont profité de cette aide et doivent maintenant commencer le remboursement par le biais de leur flux de trésorerie. Certains entrepreneurs n'ont malheureusement pas pu aménager leur terre et exploiter toute leur capacité de production dans les délais prévus au départ, et dans certains cas, le revenu ne suffira pas à assurer le service de la dette. L'Agence travaillera avec ces clients au cas par cas et demandera l'aide du spécialiste de la culture des petits fruits au ministère de l'Agriculture et des Forêts, s'il y a lieu.

L'industrie provinciale de la canneberge est toujours de taille modeste, mais la production augmente annuellement, la récolte étant passée de 290 000 à 320 000 livres de 2003 à 2004. Les producteurs se sont regroupés en association dans l'objectif de s'établir à long terme dans le marché et de faire augmenter les prix. Ils profitent également de l'aide accordée par le ministère de l'Agriculture et des Forêts en ce qui concerne le paiement des intérêts sur les prêts.

Les producteurs de produits soumis à la gestion de l'offre, comme les produits laitiers, les oeufs et la volaille, n'ont pas subi les difficultés financières qu'éprouvent les producteurs de produits non soumis à la gestion de l'offre. C'est pourquoi le portefeuille de l'Agence ne compte pas beaucoup de clients dans ces secteurs particuliers.

L'Agence collabore toujours étroitement avec ses clients de l'industrie agricole qui ont connu des ennuis dans leurs secteurs respectifs, et elle continuera de soutenir les entreprises viables. Au cours du dernier exercice, elle a observé une tendance à la restructuration des prêts en cours, laquelle a pour objet d'alléger la pression découlant des difficultés vécues par l'industrie agricole dans son ensemble.

Corporate Directory

Appendix A

Executive

Brian MacPhee
Chairman

Wendy Ripley
Vice-Chairman

Peter A. Wilson *
Secretary-Treasurer and Chief Executive Officer

Members of the Board

Norman Gallant
North Rustico, PE

Jean Viaene
Newtown Cross, PE

Earl Davison
Kensington, PE

Gerard LeClair
Central Kildare, PE

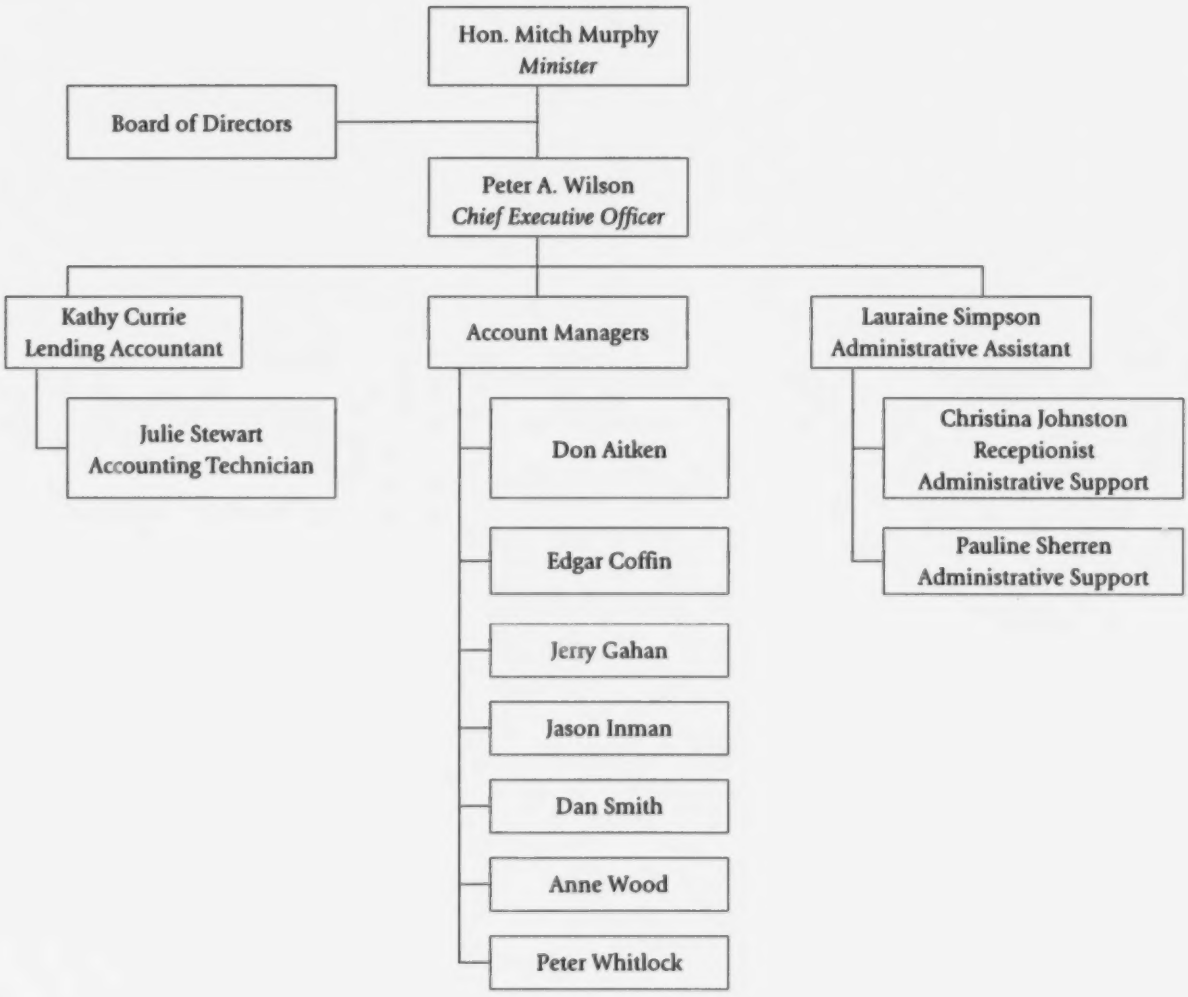
Paul R. Jelley
Deputy Provincial Treasurer

Mike O'Brien, FCA
Deputy Minister
Department of Development and Technology

* Non-voting

Organizational Chart

Appendix B



Auditor's Report

Appendix C

ARSENAULTBESTCAMERONELLIS
CHARTERED ACCOUNTANTS

ArsenaultBestCameronEllis
Prince Edward Place
80 Water Street
PO Box 455
Charlottetown, Prince Edward Island
Canada C1A 7L1
Telephone (902) 368-3100
Fax (902) 566-5074

April 27, 2005

Auditors' Report

To the Board of Directors

We have audited the balance sheet of **P.E.I. Lending Agency** as at March 31, 2005 and the statements of earnings and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at March 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

ArsenaultBestCameronEllis

Chartered Accountants

Financial Statements

Appendix D

P.E.I. Lending Agency

Balance Sheet

As at March 31, 2005

	2005 $	2004 $
Assets		
Cash	1,008,776	163,008
Accounts receivable (note 10)	3,547	253,298
Due from Province of Prince Edward Island (note 3)	2,690,000	8,831,778
Loans receivable (note 4)	130,372,719	141,083,593
Leased property (note 5)	595,400	771,795
Property holdings (note 6)	125,732	656,480
Investment in private company preferred shares	521,942	521,972
	135,318,116	152,281,924
Liabilities		
Accounts payable and accrued liabilities (note 10)	571,256	747,448
Due to Province of Prince Edward Island (note 3)	-	227,744
Notes payable (note 7)	134,746,820	151,306,692
	135,318,076	152,281,884
Contingent liabilities (note 8)		
Shareholders' Equity		
Retained earnings (deficit) - Beginning of year	40	(1,376,497)
Excess revenue for the year	-	1,376,537
Retained earnings - End of year	40	40
	135,318,116	152,281,924

Approved by the Board of Directors

Director

Director

P.E.I. Lending Agency

Statement of Earnings

For the year ended March 31, 2005

		2005	2004
	Budgeted (Unaudited) $	**Actual $**	**Actual $**
Revenue			
Grants from Province	746,200	3,436,200	4,529,100
Interest from borrowers	10,577,403	9,328,971	10,460,870
Interest from deposits	25,000	27,166	29,039
Prepayment Interest	-	22,927	-
Agricultural leases	76,197	62,571	75,493
Service fees	60,000	156,452	104,615
Post-receivership income	-	22,600	-
Gain on disposal of property holdings	-	85,162	12,172
	11,484,800	13,142,049	15,211,289
Expenses			
Office supplies and printing	23,100	18,350	20,610
Telecommunications	14,800	9,120	11,540
Rent and occupancy	107,800	102,312	105,716
Meetings and hosted conferences	4,000	5,460	3,897
Computer equipment	10,000	10,700	10,585
Advertising and promotion	3,000	3,738	5,499
Office equipment rentals	9,500	5,439	5,487
Library and subscriptions	1,200	1,372	1,750
Repairs and maintenance	6,000	-	273
Miscellaneous	1,500	3,219	3,291
Professional services	42,000	36,720	82,542
Salaries and benefits	834,855	853,053	802,202
Travel and training	39,600	20,799	23,275
Interest (note 10)	8,761,200	7,742,762	8,752,937
Provision for possible losses	1,626,245	4,329,005	4,005,148
	11,484,800	13,142,049	13,834,752
Excess revenue for the year	-	-	1,376,537

P.E.I. Lending Agency

Statement of Cash Flows

For the year ended March 31, 2005

	2005 $	2004 $
Cash provided by (used in)		
Operating activities		
Excess revenue for the year	-	1,376,537
Item not affecting cash		
Gain on disposal of property holdings	(85,162)	(12,172)
	(85,162)	1,364,365
Net change in non-cash working capital items		
Decrease in accounts receivable	249,751	620,056
Increase (decrease) in accounts payable and accrued liabilities	(176,192)	28,410
Decrease in due to Province of Prince Edward Island - current operations	(2,917,744)	(3,722,700)
	(2,929,347)	(1,709,869)
Financing activities		
Decrease in leased property (net)	176,395	238,916
Decrease in loans receivable (net)	10,710,874	940,807
Decrease in due from Province of Prince Edward Island - allowance for possible losses	8,831,778	3,308,092
Increase in notes payable	24,100,000	13,300,000
Retirement of notes payable	(40,659,873)	(17,385,844)
Decrease (increase) in investment	30	(26,972)
	3,159,204	374,999
Investing activities		
Additions to and purchases of property holdings	(5,172,403)	(849,101)
Reductions and proceeds on disposal of property holdings	5,788,314	2,321,043
	615,911	1,471,942
Change in cash	845,768	137,072
Cash - Beginning of year	163,008	25,936
Cash - End of year	1,008,776	163,008
Supplementary disclosure		
Interest and dividends received	9,434,269	10,536,363
Interest paid	7,964,160	8,707,069

1 Status of the corporation

P.E.I. Lending Agency is a Crown corporation established by a proclamation of the Lending Agency Act dated December 31, 1998. The Agency's financial results are included in the public accounts of the Province of Prince Edward Island.

2 Summary of significant accounting policies

These financial statements have been prepared in accordance with generally accepted accounting principles.

a) Allowance for possible losses

An allowance is maintained which is considered adequate to absorb all credit losses and off-balance sheet items including guarantees. The allowance is deducted from the applicable asset on the balance sheet, except for guarantees. The allowance for guarantees of $50,000 (2004 - $50,000) is included in accounts payable.

The allowance consists of specific and general provisions.

Specific provisions include the accumulated allowances for losses on particular assets required to reduce the book values to estimated realizable amounts. Specific provisions total $8,806,228 (2004 - $10,661,633).

The company reviews its loan portfolios and leased properties on an ongoing basis to assess whether a loan should be classified as impaired, or an allowance or write-off recorded.

A variety of methods are used to determine the amount expected to be recovered from impaired loans and property holdings, including estimated future cash flows and the estimated fair value of the underlying security and value of any collateral security taken.

A general provision of $2,487,931 (2004 - $2,138,457) includes accumulated allowances for losses which are prudential in nature and cannot be specifically identified. The general provision is based on past performance of similar loans, the level of the specific provision, management's judgement, the economic climate and the maturity and financial strength of the investee.

b) Loans receivable

Working capital loans are issued to qualified lenders and are recorded at cost less an allowance for possible losses. These loans bear interest at the Toronto Dominion Bank prime rate plus 1% to 2 ¾% and are repayable at the end of each sector's operating season or specific project.

Mortgage loans consist of loans issued to Prince Edward Island enterprises for purposes of acquiring property and equipment. These loans are recorded at cost less an allowance for possible losses. These loans are issued at long-term interest rates and are repayable over various terms to a maximum of 20 years with interest rates ranging from 5% to 14%.

Interest income is recorded on the accrual basis until such time as the loan is classified as non-current. A loan is classified as non-current when the Corporation has been unsuccessful in its attempt to collect arrears payments or have the loan satisfied.

An impaired loan is a loan in arrears in excess of 120 days or where in management's opinion there is no longer reasonable assurance as to the timely collection of the full amount of the principal and interest.

c) Leased property

Leased property represents the cost to acquire agricultural property based on appraised market value at the inception of the lease less an allowance for possible losses. Operating leases are negotiated with the lessee for a maximum of 5 years at a rate of interest tied to commercial lending rates. The lease rates currently range from 8.5% to 10.5%. The lease may be renewed for one five-year term after which time the lessee must repurchase the property.

Lease income is recorded on an accrual basis until the lease is repaid or the property is transferred to property holdings - foreclosed projects. When a lease is in arrears in excess of 120 days or when in management's opinion there is no longer reasonable assurance of the timely collection of the full amount of principal and interest, the lease is classified as impaired.

d) Property holdings and amortization

Office furniture and equipment and computer equipment are fully expensed in the year of acquisition. The amount expensed during the year ended March 31, 2005 was $10,700 (2004 - $11,267).

Foreclosed projects are carried at the lower of cost of the impaired asset prior to realization of the related security and the underlying estimated realizable value of the security.

The reduction from cost to estimated realizable value is recorded as an allowance for possible losses.

e) Investment in private company

Investment in preferred shares of a private company is recorded at the lower of cost and estimated realizable value.

It is not practical within constraints of timelines and cost to determine the fair value of the investment as it is a closely held private company that has no organized financial market. The estimated realizable value of this investment is based on expected future cash flows.

f) Pension liabilities

The Corporation's staff are members of the Province of Prince Edward Island pension plan. The pension plan obligation is a liability of the Province and not the Corporation and no liability for these costs has been accrued by the Corporation at March 31, 2005.

g) Estimated realizable value of financial instruments

Estimated realizable value (fair value) is subjective in nature requiring a variety of valuation techniques and assumptions. The company's financial instruments are not exchangeable and it is difficult, and often not practical, to determine their estimated realizable value. Where it is possible to estimate realizable value, the company assumes that it will not sell the assets or the liabilities, taking into account only changes in credit risk as credit risk is the main cause of change in the estimated realizable value of the company's financial instruments. Credit risk is defined as the risk that the note holder will fail to discharge an obligation in whole or in part resulting in a financial loss to this company.

h) Management estimates

The presentation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reported period. Actual results could differ from those reported.

3 Due from (to) the Province of Prince Edward Island

	2005 $	2004 $
Current operations		
Balance - Beginning of year	(227,744)	(3,950,444)
Repaid to the province	227,744	-
Grant receivable	2,690,000	3,722,700
Balance - End of year	2,690,000	(227,744)
Allowance for possible losses		
Balance - Beginning of year	8,831,778	12,139,870
Less: payment during the year	(8,831,778)	-
Less: write-offs during the year	-	(3,308,092)
Balance - End of year	-	8,831,778

As at March 31, 2005, the Province paid the remaining balance of $8,831,778 to P.E.I. Lending Agency as allowance for possible losses. P.E.I. Lending Agency paid down notes payable to the Province by the same amount as at March 31, 2005.

4 Loans receivable

					2005	2004
		Impaired loans included	Allowance for possible losses			
	Total $	in total $	General $	Specific $	Net $	Net $
Working capital loans						
Agriculture	9,052,749	641,674	487,931	1,540,000	7,024,818	8,169,936
2003 Fur Program	529,188	-	-	-	529,188	379,187
Tourism	613,790	-	-	-	613,790	610,584
Manufacturing and processing	4,338,454	-	-	100,375	4,238,079	9,551,593
Fisheries	883,136	-	-	-	883,136	819,550
Aquaculture	5,698	-	-	-	5,698	7,326
Small business	104,542	-	-	-	104,542	70,845
Cranberry	188,543	-	50,000	-	138,543	285,292
Beef Cash Flow	211,329	-	-	-	211,329	-
Hog Program	7,841,159	-	-	-	7,841,159	3,523,333
Aerospace	-	-	-	-	-	1,130,413
Information technology	67,307	-	-	-	67,307	59,493
	23,835,895	641,674	537,931	1,640,375	21,657,589	24,607,552
Mortgage loans receivable						
Agriculture	8,720,007	4,010,360	200,000	225,000	8,295,007	7,541,814
New farmer	33,721	-	-	-	33,721	32,915
Tourism	24,480,261	1,415,748	250,000	-	24,230,261	15,286,820
Manufacturing and processing	28,539,473	2,141,725	200,000	530,639	27,808,834	43,010,742
Fisheries	7,319,401	2,522,574	-	1,973,000	5,346,401	7,289,325
Aquaculture	156,609	136,652	-	-	156,609	60,629
Small business	11,664,279	-	100,000	700,000	10,864,279	10,770,113
Blueberry	10,206,424	3,414,610	1,200,000	860,000	8,146,424	7,649,306
Cranberry	2,011,687	695,894	-	400,000	1,611,687	1,439,571
2000 Hog Program	48,027	-	-	-	48,027	68,970
Aerospace	17,741,350	-	-	-	17,741,350	18,851,043
Information technology	1,402,712	-	-	-	1,402,712	1,503,704
Other	5,507,032	3,305,458	-	2,477,214	3,029,818	2,971,089
	117,830,983	17,643,021	1,950,000	7,165,853	108,715,130	116,476,041
	141,666,878	18,284,695	2,487,931	8,806,228	130,372,719	141,083,593

Continuity of allowance for possible losses

	2005 $	2004 $
Allowance for possible losses - Beginning of year	10,427,223	8,313,767
Add: Provision recorded during year	4,285,402	2,779,480
Less: Transferred to property holdings	(2,480,441)	(512,000)
Less: Loans written off during the year	(938,025)	(154,024)
Allowance for possible losses - End of year	11,294,159	10,427,223

5 Leased property

					2005	2004
		Impaired loans included	Allowance for possible losses			
	Total $	in total $	General $	Specific $	Net $	Net $
Agricultural leases	595,400	182,625	-	-	595,400	771,795

Continuity of allowance for possible losses

	2005 $	2004 $
Allowance for possible losses - Beginning of year	96,000	92,700
Add: Provision recorded during year	-	3,300
Less: Transferred to property holdings	(96,000)	-
Allowance for possible losses - End of year	-	96,000

6 Property holdings

	2005 $	2004 $
Foreclosed projects - land, buildings and equipment held for resale	1,118,449	2,933,347
Less: Allowance for possible losses	992,717	2,276,867
	125,732	656,480

Continuity of allowance for possible losses

	2005 $	2004 $
Allowance for possible losses - Beginning of year	2,276,867	3,683,412
Add: Provision recorded during year	43,603	1,222,363
Add: Transferred from loans receivable	2,480,441	512,000
Add: Transferred from lesed property	96,000	-
Less: Write-offs	(3,904,194)	(3,140,908)
Allowance for possible losses - End of year	992,717	2,276,867

7 Notes payable

	2005 $	2004 $
Short-term promissory notes	11,100,010	16,551,802
Long-term	123,646,810	134,754,890
	134,746,820	151,306,692

Short-term promissory notes are issued to the Province of Prince Edward Island with interest set monthly based on the Province's short-term lending rate in existence at the first day of the month. These notes are renewed on an ongoing basis with interest payable monthly.

The notes payable - long-term are issued to the Province of Prince Edward Island and have various repayment terms and interest rates ranging from 4.95% to 8.50%.

The aggregate amount of principal payments required in each of the next five years to meet retirement provisions is as indicated below. Certain notes becoming due during the next five years have been assumed to be refinanced under similar terms:

	$
For the year ending March 31, 2006	9,641,422
2007	9,146,195
2008	9,646,956
2009	8,662,629
2010	9,152,178

8 Contingent liabilities

a) As of March 31, 2005, P.E.I. Lending Agency was contingently liable under a loan guarantee on behalf of a development company in the amount of $65,949 (2004 - $81,563) for which P.E.I. Lending Agency has included $50,000 in its allowance for possible losses. This portion of the allowance for possible losses is included in accounts payable. The guarantee is secured by a realty mortgage, and proceeds from liquidation are expected to cover the remaining amount of the guarantee.

b) A counterclaim has been commenced against P.E.I. Lending Agency by two individuals in response to an action against these individuals for a deficiency remaining after realization on collateral held by the P.E.I. Lending Agency. The counterclaim seeks special and general damages of an unspecified amount, as well as punitive damages and costs.

The claim and counterclaim are presently ongoing, however, management has determined that no liability is likely to arise as a result of this counterclaim.

9 Commitments

The P.E.I. Lending Agency new loans approved but not disbursed at March 31, 2005 amount to $3,394,950 (2004 - $9,270,003).

10 Related party transactions

Balance Sheet

Included in accounts receivable is nil (2004 - $246,314) due from the Province of Prince Edward Island.

Included in accounts payable and accrued liabilities is $346,419 (2004 - $567,817) in accrued interest payable to the Province of Prince Edward Island.

Statement of earnings

Included in expenses is $7,742,762 (2004 - $8,752,937) in interest paid/payable to the Province of Prince Edward Island.

The above transactions were recorded in the normal course of operations.

11 Operating lease

The minimum annual lease payment required in the next year under an operating lease expiring March 31, 2006 is $41,123 in base rent plus common area expenses of approximately $60,000 annually.

12 Interest rate risk

The following table sets out the assets and liabilities on the earlier of contractual maturity or repricing date. Use of the table to derive information about the Agency's interest rate risk position is limited by the fact that borrowers may choose to terminate their financial instruments at a date earlier than contractual maturity or repricing date. Examples of this include mortgages, which are shown at contractual maturity but which could prepay earlier.

	Within 1 year $	After 1 year but within 5 years $	After 5 years $	Not interest rate sensitive $	Provision for possible losses $	Total $
Assets						
Cash	1,008,776	-	-	-	-	1,008,776
Accounts receivable	-	-	-	3,547	-	3,547
Loans receivable	44,925,214	61,376,076	35,365,588	-	(11,294,159)	130,372,719
Leased property	595,400	-	-	-	-	595,400
Property holdings	-	-	-	1,118,449	(992,717)	125,732
Investment	-	-	521,942	-	-	521,942
Total assets	46,529,390	61,376,076	35,887,530	1,121,996	(12,286,876)	132,628,116
Liabilities and surplus						
Accounts payable and accrued liabilities	-	-	-	521,255	50,000	571,255
Notes payable	20,741,205	36,607,957	77,397,658	-	-	134,746,820
Deficit	-	-	-	(2,689,959)	-	(2,689,959)
Total liabilities and surplus	20,741,205	36,607,957	77,397,658	(2,168,704)	50,000	132,628,116
Interest rate sensitivity gap	25,788,185	24,768,119	(41,510,128)	3,290,700	(12,336,876)	-
Cumulative interest rate sensitivity gap	25,788,185	50,556,304	9,046,176	12,336,876	-	-

Clarification to Note 4 of Financial Statement

Appendix E

Column 1 – Total

Represents the total loan/leases divided by economic sector. These balances represent the balance owing at March 31, 2005, before any provision for loss. The "other" category is comprised of loans classified as non-current, wherein interest is no longer being accrued.

Column 2 – Impaired

Represents loans in arrears in excess of 120 days, or where in management's opinion, there is no longer reasonable assurance as to the timely collection of the full amount of the principal and interest. Management's assessment is based on the extent of the arrears, the value of collateral security, the cash flow of the borrower and management's judgement. The impaired loans are included in the total loan/leases in Column 1.

Column 3 – Allowance for Possible Losses – General

A provision for loss based on management's judgement by sector whereby adverse economic trends suggest losses may occur, but where such losses cannot yet be determined on an item-by-item basis. Management takes into consideration past performance of similar loans, the level of specific provision and the existing economic climate.

Column 4 – Allowance for Possible Losses – Specific

Indicates the provision required to reduce particular assets from their book value to their estimated realizable value. Management takes into account the estimated future cash flow of the borrower and the estimated fair value of the collateral security held of the borrower.

Column 5 – Net

Indicates the total loan/lease (column 1), less the general and specific provisions for loss (columns 3 and 4).

Application Statistics
April 1, 2004 to March 31, 2005

Appendix F

Sector	Total Received		Amount Approved		Declined/Withdrawn	
	No.	Amount	No.	Amount	No.	Amount
Agriculture	27	9,629,375	21	7,199,375	6	2,430,000
Fisheries	17	2,744,432	16	2,632,432	1	112,000
Manufacturing and Processing	9	5,025,000	7	3,775,000	2	1,250,000
Aerospace	0	0	0	0	0	0
Information Technology	3	275,000	2	25,000	1	250,000
Small Business	13	2,528,375	12	2,488,375	1	40,000
Tourism	17	13,310,000	12	11,923,000	5	1,387,000
Fur Program	8	832,055	8	832,055	0	0
Beef Cash Flow Program	13	599,700	9	259,700	4	340,000
Hog Consolidation Program	64	8,503,322	64	8,503,322	0	0
Total	**171**	**43,447,259**	**151**	**37,638,259**	**20**	**5,809,000**